Other commentors would use the separation requirements of Section 272(b) to neuter Section 272(g)(2).[56] No one can market and sell the services of another entity without consulting with that entity. Congress knew that when it passed the Act, and it must have anticipated that the activities contemplated by Section 272(g)(2) would involve the separate affiliate and the BOC working together, i.e., joint marketing. Thus AT&T is simply wrong when it warns that "[i]f a BOC's employees are promoting the services of its affiliate in concert with that affiliate" -- if, in other words, the BOC is doing what Section 272(g)(2) expressly authorizes it to do -- the BOC must be violating Sections 272(b)(1) and (3). The correct answer is that AT&T has grossly overstated the scope and reach of Section 272(b).[57]

LDDS worries that Section 272(g)(2) "could be read implicitly to permit the [BOCs] to 'market and sell' local and long distance service jointly."[58] U S WEST disagrees only with "implicitly;" the permission is unarguable. The Conference Report states:

> New section 272(g)(2) permits a BOC, once it has [interLATA authorization], to jointly market its telephone exchange services in conjunction with the interLATA service being offered by the separate affiliate[.][59]

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[56] AT&T at 56-57; LDDS at 16-17; CompTel at 24-25.

[57] Note that, once again, AT&T cites the separation requirements as ends rather than means; it raises no evil inherent in the joint marketing permitted by Section 272(b)(2), except to claim that the separate affiliate would not be operating independently and would be sharing the use of the BOC's employees.

[58] LDDS at 16.

[59] Conference Report on S. 652 at 152. LDDS claims that the words "being offered by the separate affiliate" in the quoted passage mean that "side-by-side marketing" is permitted, but not "any action that constitutes 'offering' interLATA service." LDDS at 18. LDDS does not explain the difference between these concepts, and

More to the point, nothing in the Act prohibits a BOC from packaging its local service with its separate affiliate's interLATA service (the local service, offered under tariff, will be separate from the interLATA service). The BOC's local competitors and the separate affiliate's interLATA competitors can and will market in exactly the same fashion -- just as the Act contemplates.

LDDS' apparent concern in all this is that the BOCs will offer packages of local and interLATA service to their customers. But so long as any discounts on local service are equally available to other interLATA providers, this practice poses no competitive threat. And the Commission's recently adopted resale pricing rules require just that.[60]

V. THE MANUFACTURING RESTRICTION OF THE ACT DOES NOT PROHIBIT A BOC FROM PARTICIPATING IN THE DESIGN OF TELECOMMUNICATIONS EQUIPMENT AND CUSTOMER PREMISES EQUIPMENT (¶¶ 30, 35, 39)

The 1996 Act prohibits a BOC or BOC affiliate from manufacturing telecommunications equipment and CPE until the BOC has received in-region, interLATA authorization.[61] Once a BOC becomes authorized to manufacture such equipment, it may do so only through a separate affiliate meeting the requirements

none is readily apparent: there is no way to market and sell a service without "offering" it.

[60] First Interconnection Order ¶ 948.

[61] 1996 Act, 110 Stat. at 95 § 273(a). The Conference Report makes clear that authorization "in any in-region state" removes the prohibition. Conference Report on S. 652 at 154.

of Section 272.[62] "Manufacturing," for this purpose, has the same meaning that it did under the MFJ.[63]

However, Section 273(b)(1) states:

> Subsection (a) shall not prohibit a Bell operating company from engaging in close collaboration with any manufacturer of customer premises equipment or telecommunications equipment during the design and development of hardware, software, or combinations thereof related to such equipment.[64]

This raises questions related to the scope of the authority granted by this provision. In particular, both IDCMA and TIA claim[65] that Section 273(b)(1) does not authorize a BOC to participate in the design of equipment prior to its receipt of in-region, interLATA authorization, and that once the BOC has that authorization, it may engage in that activity only through a separate affiliate. They are wrong on both counts.

Both parties correctly note that "manufacturing," as used in the MFJ, included the design process, and both agree that the MFJ allowed the BOCs to provide "generic" or "functional" requirements or "performance specifications." IDCMA falls from grace, however, by claiming that Section 273(b)(1) intended merely to codify that right.[66] (TIA makes no mention at all of this section.)

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[62] 1996 Act, 110 Stat. at 92 § 272(a)(2)(A).
[63] Id. at 100 § 273(h).
[64] Id. at 95 § 273(b)(1).
[65] IDCMA at 5; TIA at 10-14.
[66] IDCMA at 5.

IDCMA could be right only if the MFJ Court had defined "manufacturing" to include the provision of functional or performance requirements, and then granted the BOCs a waiver to engage in those activities anyway. But that is not what the Court did. Rather, it determined that the development of generic requirements was a legitimate part of the design of a BOC's network; "manufacturing" begins only when the manufacturer begins the design process:

> The design, maintenance, and operation of the exchange networks constitutes the principal business of the [BOCs] under the decree, and it would be specious to argue that they are prohibited from engaging in this essential facet of that business.
>
> But the performance of such work is a far cry from the design of specific *products* -- a process that takes place *after* generic specification[s] for the network have been determined and disseminated. It is at that point that an equipment manufacturer designs the telecommunications or CPE products as well as the detailed plans on how to build such products or systems. That design function is an integral part of "manufacturing," and as such it is prohibited to the [BOCs].[67]

Because "manufacturing" does *not* include the provision of generic specifications, the Act did not need to grant the BOCs explicit permission to engage in that activity. Thus, by including Section 273(b)(1), Congress must have intended to expand the activities permitted to the BOCs; otherwise, that section would have no meaning, which would violate principles of statutory construction.[68] Plainly,

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[67] U.S. v. Western Elec. Co., 675 F. Supp. 655, 667-68 (D.D.C. 1987) (footnotes omitted; emphasis in original).
[68] Cf. TIA at 21.

Section 273(b)(1) allows a BOC to participate with a manufacturer in the design of equipment, and to do so immediately. That, indeed, is expressly what it states.

The question thus becomes whether a BOC may engage in this activity directly, or only through a separate affiliate. The legislative history indicates that Congress intended the former. The original Senate bill stated:

> A Bell operating company or its subsidiaries or affiliates [may] engage in close collaboration with any manufacturer of customer premises equipment or telecommunications equipment not affiliated with the Bell operating company during the design and development of hardware, software, or combinations thereof related to [such equipment.][69]

This provision would have allowed the BOCs to engage directly in design collaboration with a manufacturer. If it had intended to require a separate affiliate, it would not have included both a BOC "and its affiliates" because the only affiliate that could engage in such activity would be a separate affiliate. The Senate Report accompanying that bill confirms that reading.[70]

The House bill was clearer:

> 271(a)(1) It shall be unlawful for a Bell operating company, directly or through an affiliate, to manufacture telecommunications equipment or customer premises equipment, until the Commission has approved under section 245(c) verifications that such Bell operating company, and each Bell operating company with which it is affiliated, are in

[69] Senate Report on S.652 (Report No. 104-230) at 46.

[70] "New section 256(d) permits a BOC or its subsidiaries or affiliates to engage in close collaboration with any manufacturer of [CPE] or telecommunications equipment not affiliated with the BOC during the design and development of . . . [CPE] or telecommunications equipment." See Conference Report on S. 652, 104th Cong., 2d Sess., H.R. 104-458 at 153.

> compliance with the access and interconnection requirements of part II of this title.[71]
>
> (2) During the first 18 months after the expiration of the limitation contained in paragraph (1), a Bell operating company may engage in manufacturing telecommunications equipment or customer premises equipment only through a separate subsidiary established and operated in accordance with section 246.
>
> (b)(1) Subsection (a) shall not prohibit a Bell operating company from engaging in close collaboration with any manufacturer of customer premises equipment or telecommunications equipment during the design and development of hardware, software, or combinations thereof related to such equipment.[72]

Subsection (b)(1) would have freed the BOCs from subsection (a) as to close collaboration with a manufacturer. Subsection (a) included both a prohibition on manufacturing ((a)(1)) and a separate affiliate requirement ((a)(2)). Subsection (b)(1) lifted all of subsection (a), so it necessarily removed the separate affiliate requirement.

Given that both houses of Congress agreed on this point, one can only conclude that the Conference bill -- which became the 1996 Act -- also intended to allow the BOCs to engage directly in the design process, rather than through a separate affiliate.

VI. ACTIVITIES SUBJECT TO SECTION 272 REQUIREMENTS (¶¶ 31-54)

A. Internet Access Services Are Not InterLATA Information Services (¶¶ 41-43)

[71] House Report on H.R. 1555 (Report No. 104-204) 104th Cong., 1st Sess. at 15-16.
[72] Id. at 16.

In its comments MFS spends a considerable amount of time and effort attempting to characterize BOC-provided Internet access services as interLATA information services subject to Sections 271 and 272 of the 1996 Act.[73] This characterization, if accepted by the Commission, would require the BOCs to meet the 271 checklist before offering Internet access service and, additionally, to offer such service only through a Section 272 subsidiary. MFS argues for extensive Commission regulation and oversight of BOC-provided Internet access services, including Section 272 separation. However, as to itself and other similarly situated companies, MFS argues that the Commission should not regulate the provision of Internet access services at all. MFS goes on to argue that Internet services do not, in fact, meet the definition of "telecommunications services." MFS then claims that such an obviously inconsistent regulatory treatment was the intent of Congress in passing the 1996 Act, and that the Commission should implement the full panoply of Section 271 and 272 requirements on BOCs which propose to offer such services.

MFS' arguments on this issue are transparent and unsupportable. Locally provided Internet access service is no more an interLATA information service than is any other type of local access provided to an independently operated interLATA network, including the networks operated by the interexchange carriers. MFS contends that Internet access is an interLATA service simply because an end user is able to send and receive information across LATA boundaries. If this contention were true, then all local service would be interLATA in nature simply because of the

[73] MFS at 16-26.

ability to make a long distance call. Such a result is obviously absurd and unsupported by any prior Commission decisions or other precedent.

The Internet is unique in design and operation from commercially provided carrier telecommunications networks,.[74] but fundamentally, it is simply a computer network (actually a number of networks) which provides transport of packagized data across the United States and the world.[75] This obviously includes the potential for transport of data across LATA boundaries. The key point, however, is that the BOCs have no ownership or control over the transport service provided on the Internet network. In providing local access, the BOCs are not themselves providing interLATA transport. Nor do the BOCs control the information or content which flows on the Internet. Moreover, the Internet is not a carrier service -- in fact, once an Internet service provider hands data off into the Internet, it loses control over the routing of the message -- and indeed has no choice of the actual transmission path the message takes. An Internet service provider does not pay interstate switched access charges when the Internet is engaged on an integrated call which uses local exchange switching facilities. U S WEST or any other BOC which provides local access to the Internet is not providing an interLATA service simply by the virtue of providing such access.

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[74] In fact, the Commission has specifically avoided classifying the Internet as a common carrier service.

[75] Congress in fact defines the "Internet" to mean "the international computer network of both Federal and non-Federal interoperable packet switched data networks." 47 USC § 230(e)(1).

MFS also improperly attempts to characterize Internet access as an information service.[76] Access to the Internet by itself does not meet the definition of information service provided in the 1996 Act.

> the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.[77]

In providing access to the Internet, a BOC does not generate, acquire, store, transform, or otherwise manipulate the information which flows across the Internet. End users, on their own computer systems, submit requests to other computer systems on the network, and those systems reply by sending the requested information. While at times it may be necessary to convert a message to the Internet protocol (an enhanced service), an information service is clearly not provided. In providing access, a BOC has no control over the content of the information sent or requested by end users. It is simply providing a local connection to the independently operated worldwide Internet networks.

B. Information Services Should Be Classified As InterLATA Only When The Service Integrates InterLATA Transport To The End User (¶¶ 43-47)

Voice-Tel and ITAA argue that the Commission should classify all information services that are capable of accessing, or being accessed by, interLATA

[76] MFS at 16-17.

[77] 1996 Act, 110 Stat. at 59 § 3(a)(41).

facilities as interLATA information services.[78] Both parties contend that it is difficult, if not impossible, to distinguish between intraLATA and interLATA access to a LEC information server. Therefore, based on that difficulty, all information services provided by the BOCs should be classified as interLATA. These arguments are patently absurd. In effect, this approach would eliminate the possibility of there being any intraLATA information or enhanced services. Virtually all information services are capable of being accessed from remote LATAs via the public switched network. Under the proposals of Voice-Tel and ITAA, all information services would therefore be automatically classified as interLATA.[79] Congress certainly did not intend, nor should the Commission consider, such an ill-considered concept. Reasoned analysis obviously seeks to recognize Congress' intent to permit a wide variety of information services to be offered directly by a BOC -- an intent which would be countermanded by acceptance of Voice-Tel's position.

ITAA separately suggests that the Commission should impose "substantially the same -- if not identical -- separate affiliate requirements on the BOCs' provisioning of electronic publishing and other information services."[80] As ITAA has itself acknowledged, information services and electronic publishing are covered

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[78] Voice-Tel at 12-13; ITAA at 9-10.

[79] Based upon this classification, ITAA further proposes that all information services be provided in Section 272 separate subsidiaries. Obviously, the Act does not require such treatment. The Commission must therefore reject ITAA's proposals out of hand.

[80] ITAA at 14-15.

under two entirely separate sections in the Act (information services under Section 272 and electronic publishing under Section 274). Indeed, a BOC may not even directly own a Section 274 subsidiary.[81] To suggest that the Commission can simply ignore the statutory separation of these two sections and their particular separate affiliate requirements is foolish, at best. Congress specifically treated information services and electronic publishing separately, and the Commission should give effect to this clearly discernable intent.

As noted in its comments, U S WEST believes that an information service should be considered to be interLATA only where the service integrates the interLATA transmission component between the service provider and the end user and that transmission component is provided specifically by the BOC offering the service. Should an information service be offered on a stand-alone basis, without an interLATA transmission component integrated, then that service should be considered intraLATA or local in nature, even if the likelihood exists that the service will be accessed from another LATA -- and even if a customer calling the information service selected the BOC's own toll service for interLATA transmission.

C. Additional Incidental InterLATA Safeguards Are Unnecessary (¶¶ 37-40, 94-107)

With respect to incidental and previously authorized interLATA services, several parties suggest that U S WEST and the other BOCs should be subject to accounting, reporting, and a multitude of other non-structural safeguards.[82] Again,

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[81] 1996 Act, 110 Stat. at 100 § 274(b).

[82] See, e.g., CompTel at 8-11; MCI at 10-11.

it is apparent that these parties have little interest in the 1996 Act or in the Commission's proper implementation of the Act. Even though the Act calls for "a pro-competitive, de-regulatory national policy framework . . .," these parties contend that the Commission should instead impose highly restrictive regulatory requirements on offerings the BOCs were specifically allowed to provide without a separate subsidiary. They go on to suggest that the imposition of additional regulatory burdens on the BOCs is necessary to prevent the BOCs from exercising their market power. The Act never even hints at such anti-competitive actions.

As U S WEST and others noted in their comments, additional safeguards in these limited areas are unnecessary.[83] Arguments which refer to a BOC's continued market power are simply strawmen in view of the interconnection and resale requirements of the 1996 Act. Additionally, to the extent that such services are offered by a BOC, they will still be subject to sufficient regulation including: Part 32 and Part 64 accounting rules; Open Network Architecture ("ONA") requirements; and the interconnection requirements recently imposed by the Commission. These existing regulations provide ample protection from any of the potential harms that have been suggested, but never demonstrated, by U S WEST's competitors.

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[83] U S WEST Comments at 18-19.

VII. BOC IN-REGION INTERLATA AFFILIATES SHOULD BE CLASSIFIED AS NONDOMINANT BECAUSE NO PARTY HAS PROVEN THAT THEY WILL POSSESS MARKET POWER IN THE RELEVANT MARKET (¶¶ 108-152)

IXCs, resellers and cable companies argued for classification of BOCs as dominant when they provide in-region interLATA service.[84] These companies have a vested interest in keeping BOCs out of the interLATA market as long as possible and forcing them to compete with one hand tied behind their backs. None of the arguments advanced by these commentors overcomes the weight and substance of the BOCs' arguments that dominant carrier classification is unwarranted and would reduce the benefits of competition to consumers.[85] U S WEST reasserts its position that these competitors, not the BOCs, bear the burden of proof on the classification issue, and further contends that they failed miserably.[86]

Lacking sound economic theory or legal support for their arguments, the BOCs' competitors resort to all kinds of tactics to serve their anticompetitive ends. One tactic almost uniformly employed is evasion. The basic issue is whether the BOCs' affiliates have market power in the interLATA market (not whether they

[84] See, e.g., MCI at 57-71; TRA at 22-27; CCTA at 11-14.

[85] See, e.g., Bell Atlantic at 14-20 (Taylor Affidavit at 5-6). U S WEST agrees with PacTel that BOC affiliates providing in-region international services should be classified as non-dominant, regardless of the determination made for domestic services. PacTel at 68-69.

[86] CompTel complains bitterly about the burden it properly bears. See CompTel at 36-37, latching onto the Notice's incorrect spin on the primary issue (i.e. whether to "relax" -- rather than impose -- dominant carrier regulation for in-region, interLATA services provided by BOC affiliates).

might have it).[87] Most of the commentors arguing for dominant carrier regulation spend almost all their time discussing the local exchange and exchange access markets, and little or no time on the relevant market: the interLATA market.[88] This fixation on the BOCs' primary markets skirts the issue, and no amount of hand-wringing or wild imaginings about the possible consequences of supposed "BOC control of local bottlenecks" can substitute for a showing of actual (not hypothetical) market power in the interLATA market. Without that showing, there is no basis for imposing dominant carrier regulation on BOC in-region interLATA affiliates.[89]

Unfazed by the inconsistency of arguing that BOC in-region interLATA affiliates are dominant while it (of course) is not,[90] AT&T sets up an impossible double standard: when evaluating AT&T's power in the interLATA market, the Commission should look at the interLATA market, but when evaluating the BOCs' power in the interLATA market, the Commission should look at the local exchange market. AT&T cannot have it both ways. Having successfully argued that the interLATA market is so competitive that not even AT&T can dominate it, AT&T faces a major credibility gap. Undaunted, AT&T claims that "[t]he proper markets

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[87] Ameritech correctly notes at 9-10 that "[d]ominant carrier status does not apply, and has never been applied, for firms that might acquire [the ability to raise prices] at some unspecified point in the future."

[88] See, e.g., Frontier at 7-9; Excel at 9-10.

[89] In an even more blatantly evasive maneuver, CompTel argues that the question of whether the BOC affiliates will possess market power in the relevant market is "beside the point." CompTel at 34.

[90] See In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd. 3271 (1995).

to analyze here . . . are the markets for local and access services . . . rather than the interexchange market."[91]

AT&T makes yet another astonishing claim: "[s]ettled law establishes that market definitions and market share analyses are unnecessary when the presence of market power can be proved directly. . . ."[92] According to AT&T, market definition is "irrelevant."[93] AT&T is simply wrong. Market power cannot be assumed from the existence of anything, nor can it be proven in a vacuum. Settled law says that a relevant market with product and geographic dimensions must first be defined.[94] Then, and only then, can market power (i.e., the ability to control prices) be assessed based on a number of factors, including the size, structure, and share of the firms present in the market, the existence of barriers to entry, excess capacity, supply and demand conditions, etc.[95] U S WEST reasserts that BOC market power in the local exchange market can no longer be presumed, and BOC competitors can no longer gain marketplace advantages through the regulatory process simply by invoking the word "bottleneck."

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[91] AT&T at 61-62.

[92] Id. at 61. AT&T cites no law in support of this astounding claim, and refers only to its comments filed in another proceeding as if those somehow constitute binding precedent.

[93] Id.

[94] As the U.S. Supreme Court stated 30 years ago, "[w]ithout a definition of [the relevant market] there is no way to measure [a defendant's] ability to lessen or destroy competition." Walker Process Equipment, Inc. v. Food. Mach. & Chem. Corp. 382 U.S. 172, 177 (1965).

[95] See 1992 Department of Justice/Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 at 20,569.

Another popular tactic is: "shoot first, ask questions later." While many commentors admit that telecommunications markets are changing rapidly and that "no one can predict the future,"[96] they nonetheless argue that the Commission should impose dominant carrier regulation now just in case the BOCs wiggle out of their regulatory straitjackets and somehow figure out how to control prices immediately in the interLATA market. The Commission would be wise to do just the opposite: assume nondominance and impose dominant carrier regulation on a case-by-case basis only if warranted under actual market conditions. The Commission risks nothing by adopting a wait-and-see strategy because no BOC affiliate is even authorized to provide in-region, interLATA service, let alone control prices for those services. Besides, any determination that the Commission makes now about BOC market power in the interLATA market will be inherently suspect in a very short period of time. Market power analysis is by its very nature fact-dependent and empirical, and cannot be based on speculation about what a market might look like in the future.

Some commentors practically admit that there is no real basis for dominant carrier regulation, but urge the Commission to impose it anyway because "any regulation" that slows down the BOCs and protects the incumbents' pocketbooks will do. TRA, for example, at a loss to show how under any plausible economic theory the BOCs will have market power in the interLATA market, claims that "the issue is not one of economic theory, but of intense practicality," and that "[a]ny

[96] Sprint at 60.

regulation which will reduce even incrementally these adverse impacts is worthy of implementation from a small competitor's perspective."[97] Nowhere did Congress say that "small competitors"[98] are immune and need special protection from competition. Imposing dominant carrier regulation just to give "the little guy" some help in what will soon be a fiercely competitive marketplace would not be in the public interest. The market, not the Commission, should decide winners and losers. May the most efficient competitors win.

MFS takes a different tack. It submits a "Numerical Illustration" that purports to show "how a BOC could leverage its control of essential facilities to obtain a competitive advantage in vertical markets." As the attached economic analysis shows,[99] MFS' illustration in fact demonstrates that imputation works, in the sense that the competitor with the lowest cost is able to reflect its cost advantage by charging the lowest price. Indeed, MFS' examples show that imputation safeguards, properly applied, prevent a BOC from obtaining any unfair competitive advantage in vertical markets.

Whatever tactic or angle they pursue, the BOCs' competitors who argued for dominant carrier regulation are all hoping that the Commission will re-embrace the old "I'll-hold-him-you-hit-him" approach that the Commission itself thoroughly repudiated only 10 months ago when it reclassified AT&T as non-dominant in the

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[97] TRA at 26-27.

[98] Many of TRA's members are, in fact, very large companies with substantial resources.

[99] Timothy J. Tardiff, Economic Analysis of MFS' Numerical Illustrations, attached hereto.

interLATA market. A return to that approach would be costly for the BOCs, costly for the Commission, and -- most important -- costly for consumers. "Less regulation is a desirable goal . . . because it will spur further technological innovation, greater competition and job development."[100]

VIII. A SECTION 272 SUBSIDIARY WHICH IS NOT A SUCCESSOR OR ASSIGN OF THE INCUMBENT LEC IN THE PROVISION OF LOCAL EXCHANGE SERVICE IS NOT AN INCUMBENT LEC (¶¶ 70-71, 79)

Several commenting parties argue that a BOC Section 272 subsidiary cannot provide any local exchange services without becoming a BOC and/or an incumbent LEC itself.[101] As U S WEST pointed out in its initial comments, a Section 272 subsidiary cannot lawfully be deemed to be either a BOC or an incumbent LEC unless it is a successor or assign of the BOC in the provision of local exchange services.[102] Our point was not that an incumbent LEC could simply transfer its local exchange business to another corporate entity, thereby avoiding the strictures of Section 251(c) -- although, if such avoidance through transfer could be lawfully accomplished, it would still presumably be subject to scrutiny by the Commission pursuant to Section 214 of the Communications Act. Our point was not to argue the extent to which an incumbent LEC could avoid the provisions of Section 251(c) of the Act by transferring its local exchange physical plant to a Section 272 subsidiary. To the contrary, we simply pointed out that, in the absence of the legal and factual premises on which to base the conclusion that the Section 272 subsidiary was a

[100] Statements of Congressman Hyde, 142 Cong. Rec. H. 1145, 1157.
[101] See, e.g., NCTA at 7-11; CCTA at 5-10.
[102] U S WEST Comments at 53-59.

successor or assign of the incumbent LEC/BOC, the Section 272 subsidiary could not be defined as either an incumbent LEC or a BOC. It is clear that the statutory language uses the phrase "successor or assign" deliberately, and it is meant to apply BOC and incumbent LEC status only to those affiliates to whom local exchange facilities are formally transferred -- who "stand in the shoes" of the incumbent LEC in the provision of the same service the incumbent LEC had provided until displaced by the subsidiary.

NCTA's argument to the contrary, by relying entirely upon patent misreadings of the Act, demonstrates how far NCTA's position is from reality. NCTA asserts four bases for its contention that the BOCs may not lawfully "establish[ ] a single, multi-purpose affiliate that would provide both local exchange service and in-region interLATA services."[103]

First, NCTA posits that "the statute bars a BOC, and any affiliate of a BOC, from providing in-region interLATA services unless the BOC has satisfied the requirements of Section 271."[104] This assertion is clearly false. BOCs may provide in-region interLATA services today if those services are classified as "incidental" services, and some of those incidental interLATA services may be provided only via a Section 272 subsidiary.[105] In other words, NCTA's premise that BOCs cannot provide in-region interLATA services today is simply wrong -- indeed, a Section 272 subsidiary is necessary today for certain in-region interLATA services.

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[103] NCTA at 9.

[104] Id.

[105] 1996 Act, 110 Stat. at 86 § 271(b)(3), 91 § 271(g), 92 § 272(a)(2)(B)(i).

Second, NCTA claims that "the provision by a BOC affiliate of local and in-region interLATA services -- whether via resale, over facilities, or through some combination of both -- through the same entity directly contravenes the structural separation between local and long distance service required by the 1996 Act."[106] This statement is equally false, as the Act expressly contemplates that a Section 272 subsidiary may "market or sell telephone exchange services provided by the Bell operating company" so long as the same opportunity is given to similarly situated competitors.[107] This is the classic definition of resale.

Third, NCTA contends that a Section 272 subsidiary providing local exchange and exchange access-type services would "sow confusion in the marketplace" based on an incomprehensible theory that a Section 272 subsidiary -- with no interLATA market share (and some delay before it can enter the full interLATA market) and no local exchange or exchange access market share -- would have a "headstart in the evolving competitive marketplace" which would somehow be unfair.[108] This argument is, as noted, not comprehensible, as it is simply impossible for such a headstart to be gained even if the entire local exchange were transferred to the subsidiary.

Finally, NCTA claims that "the intent of the Act could be thwarted by providing a vehicle for a BOC to avoid its obligations and requirements under

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[106] NCTA at 10.
[107] 1996 Act, 110 Stat. at 94 § 272(g)(1).
[108] NCTA at 10-11.

Section 251(c)."[109] This argument would have some credibility if it were U S WEST's position that it could avoid the requirements of Section 251 by assigning its local exchange facilities and business to a subsidiary. But this is not the position before the Commission. NCTA is claiming, wrongly, that a U S WEST Section 272 subsidiary cannot provide any local exchange services at all, even if it does not do so as a successor or assign of U S WEST in the provision of local exchange service. This position is palpably wrong, and is based entirely on interpretations of the Act which are inaccurate on their face.

NCTA's position stands in stark contrast to the comments of LDDS. LDDS addresses this same issue, and paraphrases its position (and that of the Commission) as follows: "The FCC tentatively concluded that an RBOC may not evade its obligations under Section 272 simply by transferring its local exchange network capability to another affiliate (including its interLATA affiliate)."[110] We agree.

LDDS goes on to conclude that the Commission should "prohibit the telephone operating company from transferring any of its network facilities or capabilities to the interLATA affiliate."[111] LDDS concludes that "[t]his reading does not mean that the interLATA affiliate may not provide a package of services that includes local exchange service. As discussed above, the interLATA affiliate simply

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[109] Id. at 11.
[110] LDDS at 18.
[111] Id. at 19 (emphasis in original).

must do so by obtaining local exchange service or unbundled network elements on the same basis that its competitors do."[112]

While we have some disagreement with LDDS on the details of its analysis, its basic thrust is clearly correct. Namely, so long as a Section 272 subsidiary (or other subsidiary) complies with the basic requirement that it "operate independently" from the incumbent LEC, and purchases incumbent LEC facilities and services from the incumbent LEC on the same basis as other competitors, and so long as it is not a successor or assign of the incumbent LEC in the provision of local exchange service, there is no basis in law or logic to classify the subsidiary as either an incumbent LEC or a BOC.

Respectfully submitted,

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[112] Id.

ATTACHMENT

Economic Analysis of MFS's Numerical Illustration

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1. MFS has provided a numerical illustration that allegedly demonstrates how a Bell Operating Company (BOC) can "leverage its control over essential facilities to obtain a competitive advantage in vertical markets." MFS claims this could happen even with price cap and imputation safeguards. The illustration leads MFS to conclude that (1) competition for essential services needs to develop and (2) the BOC should be required to sell essential inputs to alternative providers at incremental cost. While I agree with the first of MFS's two conclusions, I disagree with the rest of the analysis.
2. The fundamental flaw in MFS's analysis is that the alternative providers in its example are *less* efficient, contrary to MFS's characterization. They are less efficient because they incur *additional* fixed costs to provide toll service, while the BOC's fixed costs are shared between providing the essential input and the competitive toll service. Accordingly, over the range of volumes considered in MFS's illustration, it always costs more when the alternative providers offer toll service. In addition, standard imputation rules, which require the BOC to include at least as much margin (price - cost) in the prices for its competitive services that it imposes on alternative providers in the price for essential inputs, allow efficient competitors a fair opportunity to survive and prosper.[2]
3. MFS's illustration assumes that the BOC incurs fixed costs of $400 million. Because such fixed costs do not vary with the volume of either output, they would go away only if the BOC ceased providing both the essential input and the competitive service. The BOC also has incremental costs of $0.03 per minute to provide the essential input, which it sells to alternative providers at $0.07 per minute ($0.04 per minute margin). Its incremental cost is $0.10 per minute to provide the competitive service. The latter cost includes the $0.03 for the essential input plus $0.07 of additional costs to provide the competitive service.

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[2] J.A. Hausman and T.J. Tardiff, "Efficient Local Competition," *Antitrust Bulletin*, Vol. 40, 1995, pp. 529-556.

4. The alternative providers are assumed to have fixed costs of $300 million and incremental cost of $0.06 to produce the competitive service, over and above payments to the BOC for the essential input. MFS incorrectly claims that because (1) the alternative provider's incremental cost of $0.06 (excluding payments for the essential input) is less than the BOC's additional incremental cost of $0.07 and (2) its fixed costs are lower, it is more efficient.
5. MFS fails to realize that the alternative provider's fixed costs are incremental to the production of the competitive service, i.e., they only go away when the alternative provider ceases to provide service. In contrast, the BOC's fixed costs remain as long as it provides the essential input.
6. MFS presents two calculations, illustrated in Tables 1 and 2. In the first calculation the market price for the competitive service is $0.22 per minute. In this example, both the BOC and the alternative provider earn healthy profit margins of 27 percent and 38 percent, respectively. Therefore, what is being illustrated is not competition, but umbrella pricing. That is, the alternative providers enjoy supracompetitive profits by pricing at artificially high prices that are likely the result of regulation.
7. On a per unit basis, the BOC is more efficient than the alternative provider: the BOC's incremental costs are $0.10, while the competitor imposes costs of $0.12 per minute to produce the 10 billion minutes listed in Table 1. This unit cost consists of $0.03 attributable to the essential input, $0.06 additional cost for using its own facilities, plus $0.03 in recovering the $300 million of fixed costs over 10 billion minutes.
8. In Table 2, the BOC lowers its price to $0.14, which is the minimum price it can charge under procompetitive imputation rules. That is, at $0.14, the BOC includes the same margin over incremental cost in its competitive price that it includes in the charges for essential inputs sold to alternative providers. In this example, the margin is $0.04 per minute.
9. Although the market expands because of the lower price (and consumers obviously benefit), the alternative provider has insufficient volume to recover its fixed costs.[3] That is, while it earns a margin of $0.01 per minute (it incurs $0.13 per minute to provide service, consisting

[3] Both the alternative provider and the BOC grow by about the same amount, holding their market shares roughly constant. The demand stimulation in MFS's example implies a market price elasticity of about -0.68.